

This letter discusses leases and leasing related charges. 86 Ill. Adm. Code 130.220. (This is a GIL.)

October 22, 2007

Dear Xxxxx:

This letter is in response to your letter dated April 17, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

Our organization primarily engages in two types of lease transactions:

- **Conditional Sales** - (Capital Leases) contracts in which the lessee obtains title to the equipment at the end of the lease term or purchases the equipment for a nominal fee at the end of the lease term.
- **True leases** - (Operating Leases) contracts in which the lessee has the option to purchase the equipment or return it at the end of the lease.

We are looking for general sales/rental/excise/use tax guidance in three areas.

1. **Tax treatment at time of booking** for both conditional sales and true leases.
Is the tax owed on the monthly stream of payments or is the tax owed up front? If upfront, is the tax calculated on the equipment purchase price or total amount financed. How would the residual on an upfront contract be taxed, upfront at time of booking or at the end of the lease when the equipment is purchased?
2. **Taxability of misc fees billed to the lessee.**
 - We pass the personal property taxes onto the contracts by either estimate prior to receiving and paying out the taxes or the actual amount after we have paid it along with an annual handling fee for the reimbursement of the expense of administration.

- We bill out a property damage surcharge fee for not having an insurance certificate on file per the lease agreement. This does not get the lessee insurance coverage for the equipment they lease, but rather it is a penalty for not providing an insurance certificate per the lease agreement which would protect our interest in case of a loss.
 - We also have various charges for being delinquent on their lease payments.
 - We have a collection charge for working on collection of delinquent accounts.
 - We charge late fees automatically if it [sic] the rental has not been paid by the grace period.
 - We charge credit report charges if they are delinquent and we need to research their financial stability.
 - We charge bad check charges when their payment is returned from the bank.
 - We bill out maintenance fees to our lessees which is a set amount per their contract that is not related to the amount of service calls we will have on that equipment. We pass all maintenance fees collect [sic] onto our vendors, but we bill it to the lessee on the vendor's behalf.
 - A charge is billed to the lessee at the beginning of the lease for documenting the lease. This fee can be retained by us or reimbursement for a fee we had to pay to the dealer. The doc fees that are retained by us can be collected from either the broker or the lessee.
 - At the beginning of the lease we also charge an interim rent or due date adjustment fee if the lessee chooses to move their due date. This is interest for moving the payment due date out.
3. **Clarification on the renewal tax treatment at the end of the lease.** At the end of the lease term some of our contracts go into an automatic renewal if the lessee does not give notice of purchasing the residual. The renewal fee can be retained by us or split and shared by both the vendor and ourselves. What is the tax treatment of the renewal in either instance? The renewal is basically continuing the lease payments, but is not considered part of the contract balance.

Thank you for taking the time to assist us in this matter. We appreciate any guidance that you can give us on the above items.

DEPARTMENT'S RESPONSE

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101. If no tangible personal property is being transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply.

LEASES

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess by remitting the tax directly to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of the enclosed copy of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. There are also some limited exceptions to the general rule described in the preceding paragraphs. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under leases of one year or longer. See the enclosed copy of 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See the enclosed copy of 86 Ill. Adm. Code 130.2011.

MISCELLANEOUS FEES

In regard to personal property taxes and associated annual handling fee, the personal property tax in Illinois was abolished beginning January 1, 1979.

The taxability of maintenance agreements depends upon if charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. In those instances, no tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code Sec. 140.301(b)(3).

In regard to the various other charges and fees referenced in your letter, if the transaction is a true lease, then no tax is incurred on those charges or fees. If the transaction is a conditional sale, please see 86 Ill. Adm. Code 130.420 and 130.410, the Department's rules regarding finance charges, penalties, discounts, and costs of doing business. Without reviewing the agreements, such as through a private letter ruling request, we cannot provide you with specific rulings on those fees and charges.

RENEWAL FEE

Generally, annual renewal fees are not subject to Retailers' Occupation Tax. If, however, the fees are actually gross receipts for the sale of tangible personal property under a conditional sale agreement, they would be subject to tax, even if separately stated on the invoice.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
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